Bail-in or bail-instability

Banking supervisors and legislators have opted firmly for the bail-in tool as a key part of crisis management at banks. According to the FSB, the EU competition authorities and the EU banking regulators, bail-in is the critical element in any scenario to resolve a bank that is in financial trouble. Before state aid can be dispensed, capital and the (newly reinvented tier 3 capital under another name) bail-inable debt capital requirement under the banking resolution and recovery directive needs to be written down in part or in full, or converted into shares. State aid includes any form of investment (equity or loans) at non-market terms, and includes the dispensation of money from the recently introduced resolution funds (because these funds are government controlled, even though they are funded by the banking sector). There have now been some minor try-outs of crisis management built around a bail-in at failing bank, for instance in Cyprus and Italy. In the absence of sufficient share capital, these try-outs have also involved bailing in depositors who had more than 100.000 euro (the deposit guarantee limit in the EU) entrusted to the failing bank, as well as bailing in consumers who unwittingly bought 'saving certificates' that turned out to be subordinated bonds (the term 'subordinated' means the same as the term 'blah blah' to many depositors).

If the state does not bear the risk, who does?

In Cyprus, the announcement of a bail-in of protected depositors caused social instability to the extent that bail-in enforcers backed down. In the final scenario, only the amount of deposits over 100.000 euro were bailed in. In Italy, the social repercussions of bailing in poor consumers who bought a subordinated piece of paper may well also lead to backtracking on the bail-in. A possible route would be by (ex post) declaring that selling subordinated bonds to consumers constitutes misselling, for which damages will need to be paid to the consumer (to the extent of the bailed-in amount, de facto annulling the bail-in). Though selling bonds or shares or subordinated deposits to only slightly financially aware retail investors did not seem to disturb anyone prior to the crisis, selling coco's and similar paper already appears to be on the radar of conduct of business supervisors as most likely unsuitable for consumers. A high-risk investment in any bail-inable debt (under bail-in rules including senior unsecured debt, or savings exceeding 100.000 euro) may indeed well be prohibited as unsuitable for non-financially educated consumers and small companies (which can only be supported). These partial retrenchments of the scope of bail-in so far only concerned consumers, however, though both consumers and the financial system as a whole may also be harmed by bailing in claims on a failing bank held by of other banks, pension funds, insurers and so on. The likelihood of such damage to the financial system and directly or indirectly or to large groups of retail clients of bailed in financial institutions increases if a bail-in would ever need to be performed at a systemic bank.

Lacking impact assessment of the bail-in tool

Research on the consequences of a bail-in is still in its infancy. A detailed impact assessment appears to be lacking, with the main driver of bail-in legislation being that 'the taxpayer', whomever that may be, needs to be prevented from having to foot the bill of state intervention at systemic banks and other systemic financial institutions. Most likely, 'the taxpayer' is one of the consumers or companies (or public authorities), whose claim on the bank is being bailed in, or the beneficiary of pensions or insurance pay outs by pension funds and insurers whose claims on a failing bank are being bailed in. Whether concentrating this pain on the few entities with a direct link to the bank is fair or not is debatable, but it certainly will mean that these unhappy few will be less profitable companies, poorer consumers, and loss making financial investors, who will pay less taxes, buy less stuff and employ fewer people in the future. Tax income will thus likely be reduced, possibly to the same extent (or higher) than a more traditional form of state aid would amount to. This will almost certainly be the case after deducting future income from selling the 'investment' (now funded by state aid) in a failing bank, or by recouping emergency loans made to a formerly failing bank. The main effect of a bail-in requirement may well be that the pay out for crisis resolution is now channelled directly between investors end creditors/depositors and the bank, instead of via the sovereign balance sheet, though the net effect on both the balance sheet of the state and of retail clients and financial institution may be the same or worse.

What I personally would like to know, as guesswork is all we have now, is what would actually happen to the financial system and to the taxpayers if the bail-in tool would be applied to one of the bigger banks. I think this is also essential information for any banking supervisor or crisis manager such as the Eurozone Single Resolution Fund before they apply the bail-in tool to any systemic bank, to avoid creating financial instability. So far the tool has mainly been applied to minnows amongst the banks, and even there it has hurt. Can we ask EBA, the ESRB, the SRB, the ECB, the BIS and/or the FSB, to perform a stress scenario including a bail-in to each banking group that is deemed 'systemic'?

The proper application of this wonder solution under the proper care of a registered dietician, and that is what people who made the lie up were unable to understand. buying viagra from canada Men taking nitrates or alpha-blockers (antihypertensive drug) are not allowed to relax and receive blood. prescription de levitra If anything Jelly pills are anything but rubbery. viagra prescription Other men are usually seen cialis generico online http://appalachianmagazine.com/2018/0/page/10/ preferring treatment without their partner's knowledge. *Possible stress scenario test, first round effects*

In such a stress scenario, a bail-in would be applied for instance after a year of severe losses that either were written down from equity or added to formal or informal sets of non-performing loans (the latter by banks that had no spare equity to write down, and by supervisors that wanted to avoid having to face the possibility of formally declaring a bank bankrupt on their watch). After such a prolonged deterioration of a banks' health a full bail in is performed. In that case, how much would be bailed in of (1) public authorities investment (i.e. public shareholdings in banks such as SNS or RBS, as well as deposits by states and local authorities), (2) how much would be bailed in of loans or investment held by other banks (in the traditional domino-style financial instability scenario), (3) how much of loans and investments held by a pension fund/life insurer/investment fund, (4) how much of loan and investments by regular companies, and (5) how much of loans and investments by consumers. If this kind of information is not known in advance, then bailing in a systemic bank is just opening a black box of misery, similar to the repercussions of the unknown spread of risk in the financial system through securitisation bonds composed of bad quality US subprime mortgages, which were the starting point of the most recent financial crisis. The outcome of this first set of questions would only be first round effects (compounded if multiple banks would be subjected to the bail-in tool at the same time).

Second round effects

Once the information on the first set of questions on the above stress test is available, it would be interesting to assess whether those write downs would be concentrated in the uneducated part of the consumer pool, and at financially naive enterprises (and there is no reason to assume that industrial enterprises, restaurants, plumbers and bakers are financially educated enough to know that any surplus on their accounts over 100.000 euro would be bailed in, nor that most pension funds have the staff and expertise to monitor their banks). Equally, it would be interesting to investigate how many of the more educated and rich would have scampered away well before the bail-in once rumours of potential losses at a large bank would start to circulate. Lastly, it would be relevant to know the second round effects on tax income and economic growth, as well as on the pay-out (and thus taxable income) by pension funds and life insurers to retirees? And how would that over time (e.g. five years) compare to the more traditional scenario of a state funded bail-out, of which I would guess between 60 and 120 % is recouped after divestment of the bailed out systemic bank, or in the case of smaller banks: a liquidation scenario of a solvent but illiquid bank?

Final remarks

Introducing the bail-in tool in the crisis management of banks may well prove to be opportune. So far, however, there is mainly evidence to the contrary, with a loss of trust in banks and in banking regulators when consumers are bailed in. When systemic banks are bailed in, this may well turn out to lead to disproportional losses for the least financially educated. If in the future the claims of more educated parties are bailed in at failing systemic banks, this may lead to domino effects that lead to financial instability, and/or to bigger losses for 'the taxpayer' than under the more traditional state aid scenario. Until this is investigated, a bail-in at a larger bank may well trigger our next financial system crisis if that risk turns out to lie in unknown and vulnerable places. Further research is thus urgently needed.